Argentina Update

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BullTick Capital Markets

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ARGENTINA—The Second Circuit Appeals Court Rules Against Argentina

KEY POINT: The United States Second Circuit Court of Appeals decided to rule against Argentina's appeal on the ruling that had been granted earlier this year by the District Court in favor of some *holdout* holders of Argentine bonds. The decision from the appeals court basically says that the arguments made by the Argentine government on NOT violating *pari-passu* clauses ex-post the 2005 debt exchange, and regarding the "capacity to pay" by the Republic being compromised in case a judgment in favor of the holdouts were to be granted, were not strong. Hence, the appeals court decided to send back the case to the District Court, so that such Court can take the appropriate decisions on how an eventual payment to the *holdouts* involved in this case is to be made. The decision by the US Appeals Court is short-term bearish for the holders of Argentine performing debt and for the holders of GDP Warrants, because, in theory, there could be an incentive to underreport growth numbers going into next year in order to free reserves to pay for an eventual judgment, of course, assuming that Argentina does NOT appeal the decision through all the possible legal channels. We want to reiterate that, in our view, this Court decision is NOT fatal for the holders of Argentine fixed income USD-denominated assets.

BIG WIN FOR THE HOLDOUT COMMUNITY

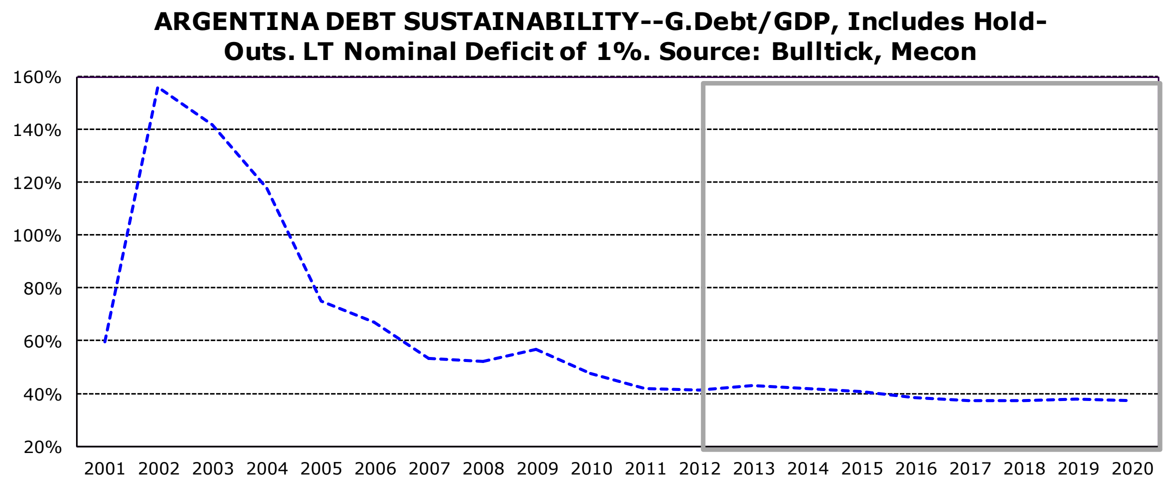
The United States Second Circuit Court of Appeals decided to rule against Argentina's appeal on the ruling that had been granted earlier this year by the District Court in favor of some *holdout* holders of Argentine bonds. **The decision from the appeals court basically says that the arguments made by the Argentine government on the Republic NOT violating *pari-passu* clauses with the holdout community ex-post the 2005 debt exchange, and regarding the "capacity to pay" by the Republic being compromised in case a judgment in favor of the holdouts were to be granted, were not strong.** Hence, the Appeals Court decided to send back the case to the District Court, so that such Court can take the appropriate decisions on how an eventual payment to the plaintiffs in the case is to be made. Here is the text of the conclusion of the ruling, clearly the most relevant for the markets:

> *"For the reasons stated, the judgments of the district court (1) granting summary judgment to plaintiffs on their claims for breach of the Equal Treatment Provision and (2) ordering Argentina to make "Ratable Payments" to plaintiffs concurrent with or in advance of its payments to holders of the 2005 and 2010 restructured debt are affirmed. The case is remanded to the district court pursuant to United States v. Jacobson, 15 F.3d 19, 22 (2d Cir. 1994) for such proceedings as are necessary to address the operation of the payment formula and the Injunctions' application to third parties and intermediary banks. Once the district court has conducted such proceedings the mandate should automatically return to this Court and to our panel for further consideration of the merits of the remedy without need for a new notice of appeal."*

MARKET IMPLICATIONS

In our view, this decision implies that the holdout community will most likely be able to ask for retroactive interest payments based on some formula that the NY Court will need to devise in the future. Clearly, the question of whether Argentina will comply with an eventual final ruling remains an open one. In addition, qualified sources are arguing that Argentina can, and most likely will appeal the decision. We are not legal experts here, yet we think that the key issue here is to understand what *"ratable payments"* means. Our lawyers tell us that "ratable payments" probably means that payments will need to be made in accordance with the original terms of the bonds in question. **As background, according to the information published by the office of the Finance Secretary, the outstanding of holdout obligations as of the end of 2011 stood at USD $6.57 billion in capital and at USD $4.59 billion in accrued interests.** Argentina's USD-denominated GDP will most likely end 2012 numbering some USD $450 billion. **In other words, at the limit, 1% of Argentina's nominal GDP could be at stake here.**

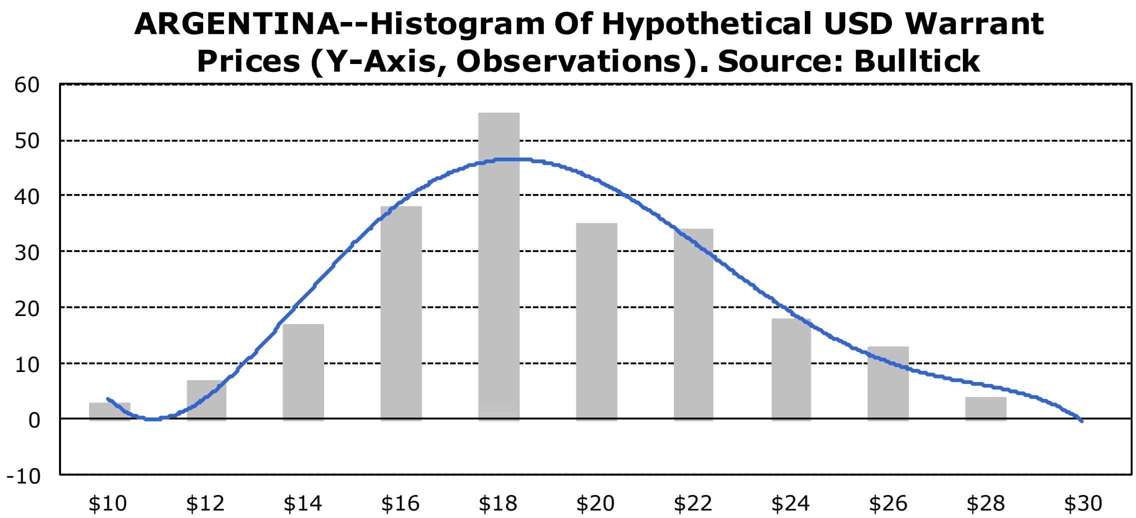
This case only touches interest payments, and therefore it will only generate precedent on the handling of the accrued interests for the other holdouts that are not included in this lawsuit. We speculate that the accrued interest load published by the Finance Secretary staff was calculated utilizing the original coupon of these bonds, meaning that such is the accurate number on the limit of the possible liability for the credit. The market reaction has been quite material, with the 5-year CDS widening by more than 400bps on the day, and the Boden 2015 falling to below $85 –meaning that the Argentine short-term benchmark lost 5 points on the day.



We speculate that the NY Court will most likely take into account Argentina's capacity to pay whenever it devises a final solution to this conundrum. Therefore, the logistical part of the "how" the payments are to be made could be of importance for the Courts. **Clearly, if Argentina were to be forced to utilize USD $4 billion in reserves at this time to comply with this payment, assuming that all other holdouts join the process, the capacity to pay of the Republic could be SEVERELY damaged.**

We think that the decision by the US Appeals Court is short-term bearish for the holders of performing debt and for the holders of GDP Warrants, because, in theory, there could be an incentive to underreport growth numbers in order to free reserves to pay for an eventual judgment. Of course, the just presented argument assumes that Argentina does in the end decide in favor of respecting the ruling, and/or assuming that this process does NOT extend for longer, something that we think is quite possible –since Argentina will likely use any available legal channel to force a drag in this process.

Despite this latest bearish development, we maintain our long-held view on the investment outlook of Argentine sovereign bonds and Buenos Aires USD-denominated NY Law bonds. Specifically, despite the shortcomings that continue to affect the performance of this credit, the world environment will most likely be more benign for Argentina in 2013. From a flow standpoint, in a "QE-driven" world, Argentina will remain a very interesting high carry investment opportunity for investors that need to boost the return of their portfolios. As we all know, high-grade returns alone are no longer sufficient to build future retirements. In terms of available supply, Buenos Aires's total debt load to GDP stood at 9.1% by the end of 2011, and at the sovereign level, the stock of public debt in the hands of the private sector now stands at about 13% of GDP.



On the macroeconomic front, despite the perennial USD shortage, we consider that it is quite feasible that Argentina could show REAL growth of 4% y/y in 2013, thanks to the reactivation of the Brazilian industrial sector and the acceleration on the rate of growth of Chinese consumption in 2013. We continue to recommend investors buy USD-denominated Argentine and BA NY-Law bonds (because of the huge carry), and we continue to argue that Argentina GDP warrants will likely gain in value from current levels ($11.5). Our in-house stochastic model is delivering at this time a fair valuation of USD $18 at this time, even after assuming that NO 2013 payment will take place, and after deflating the future flows at 14%. **In other words, we think that this credit is trading at levels that are fully discount a debt event taking place, and we continue to argue that a debt event WILL NOT take place.**

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